

Sewer Service and Use Charge Fund

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T*o account for the financing, construction, and operation of the sanitary sewer system and for San José's share of the financing, construction, and operation of the regional San José/Santa Clara Water Pollution Control Plant (WPCP). Services provided through this fund are:*

- *Sewer maintenance;*
- *Sewer rehabilitation; and*
- *Sewage treatment at the Water Pollution Control Plant*

Sewer Service and Use Charge Fund

Budget Summary

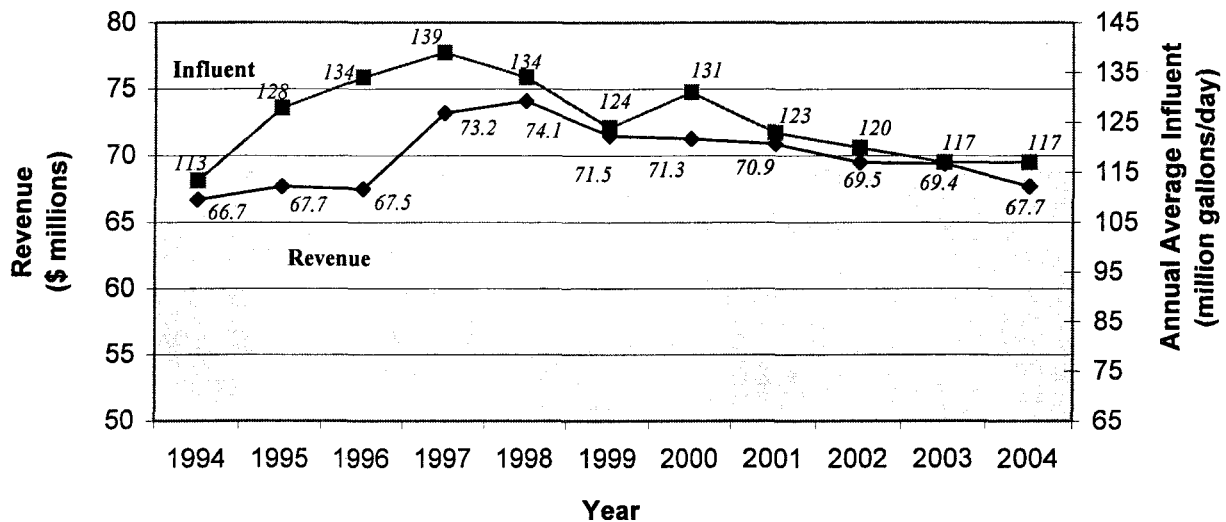
	2004-2005 Adopted	2005-2006 Adopted	Change
Sewer System Maintenance and Admin.	\$ 19,417,680	\$ 17,759,993	(8.5%)
Sanitary Sewer Rehabilitation	\$ 14,475,000	\$ 14,475,000	0.0%
Water Pollution Control Plant	\$ 44,754,736	\$ 46,482,236	3.9%

Budget Highlights 2005-2006

- ☐ The second year of a three year 4.5% Council-approved rate increase strategy to the Sewer Service and Use Charge fees was approved to adequately fund maintenance and rehabilitation of the sanitary sewer system, Water Pollution Control Plant, and the South Bay Water Recycling program.
- ☐ Refinancing of the 1995 Clean Water Financing Authority (CWFA) bonds associated with the South Bay Water Recycling program is being pursued and is anticipated to save approximately \$10 million over the remaining life of the bonds.

Budget Byte

Sewer Service and Use Charge Fund Historical Trend of Revenues in Relation to Influent Flows (millions of gallons per day compared to revenue in millions)



Sewer Service and Use Charge Fund

Fund Overview

This fund serves as the primary revenue source for several other funds which include the San José-Santa Clara Treatment Plant Operating and Capital Funds, and the Sewer Service and Use Charge Capital Improvement Fund, through annual transfers. In cooperation with the Departments of Environmental Services, Public Works, and Transportation, these funds are managed to deliver services in the most efficient and cost-effective manner.

Included in the fund balance is a Rate Stabilization Reserve of \$2 million, which was established in response to covenants in the bonds issued in 1995 to finance the construction of the South Bay Water Recycling project. The annual debt service cost for this project has been \$7.3 million, or about 10% of revenues. In 2005-2006, the refinancing of these bonds will save approximately \$10 million over the life of the bonds.

The primary source of this fund's revenues are the fees paid through tax-based assessments within the residential, commercial, and industrial sectors. Prior to 2004-2005, these fees had remained at the same rate for ten years. During the majority of this period, the revenue growth in each of these sectors was sufficient to keep pace with the associated inflation factors for the maintenance and operations of the sanitary sewer system and treatment plant. Moreover, the rate structure and growth allowed a sufficient fund balance to help defer capital costs associated with the next cycle of system maintenance and rehabilitation.

During the past several years, however, the Sewer Service and Use Charge Fund has experienced flat or declining revenues in relation to two primary factors. First, the downturn in the economy has slowed revenue growth as residential development has

decreased, rendering the growth rate to below 0.5%. Second, and more significantly, industrial and commercial migration from the area has substantially reduced revenues from these sectors.

Specifically, 3.5% of the decreased revenues are the result of six large industrial users that ceased operations in San José between 2000 and 2004, representing a loss of \$2.5 million in annual revenues. The combined impact of the economic downturn and commercial and industrial migration over the past several years has reduced revenues by a level equivalent to 9% from the high point in 1998-1999.

In the 2004-2005 Adopted Operating Budget, the City Council approved a three-year rate increase strategy of 4.5% annually. Council-approved increases in 2005-2006 represent the second year of this three-year rate increase strategy. This increases rates by \$0.89 per month, from \$19.81 to approximately \$20.70 per month for single-family residence owners. The initial rate increase has helped to increase revenues such that the current fiscal year will experience the first year of revenue growth since 1997-1998.

As a result of the trends discussed above, current year projections indicated that expenditures would have exceeded revenues, resulting in deficit spending by approximately \$2 million; and without the approved 4.5% rate increase for 2005-2006, such a revenue shortfall would have dropped the fund balance in this fund below the policy goal of 15% of annual operating expenses.

Although the majority of the operating expenditures associated with this fund have followed a stable and predictable rate of inflation, there have been several items that have exceeded expenditure projections during this period. Most notable among these has

Sewer Service and Use Charge Fund

Fund Overview (Cont'd.)

been the increase in energy costs over the past four years. Natural gas and electricity costs at the treatment plant have risen significantly despite numerous energy efficiency programs that have reduced the energy demand per million gallons treated. These costs are now significantly above 1999-2000 levels. Other items that have exceeded the general rate of inflation include vehicle and facility maintenance costs, workers' compensation costs, and insurance.

As operating expenses have increased, the Plant's capital infrastructure needs also have become ever more critical. Over 50% of the Plant's infrastructure now exceeds 30 years of age, dating back to the expansion to the wastewater treatment facility in the early to mid 1970's. Several major components of the treatment plant are now reaching the end of their useful years of service, thereby creating the need for several critical infrastructure upgrades and rehabilitation projects which are described in the 2006-2010 Adopted Capital Improvement Program.

In addition to the impending rehabilitation projects over the next ten years, it will also be necessary to fund a number of planned security projects at the Plant. The most critical project with the greatest budgetary impact is the conversion from gaseous chlorine as the primary disinfection source to alternate methods in order to address security concerns. The completion of the project, estimated for 2005-2006, is projected to increase chemical costs by \$3.5 million annually, or approximately 5% of current year revenues.

In order to maintain the fund's viability and solvency, fund necessary system operations and maintenance requirements, and address critical infrastructure rehabilitation needs, the previously conceptually approved rate increases of 4.5% will be needed in each of the next two years. Moreover, if current revenue and expenditure trends continue beyond that period, it is likely that rate increases in subsequent years will be necessary as well.

Fund Summary

	2003-2004 Actual 1	2004-2005 Adopted 2	2005-2006 Adopted 3	% Change (2 to 3)
Dollars by Sources				
Beginning Fund Balance	\$ 25,434,265	\$ 16,995,440	\$ 16,559,133	(2.6%)
Sewer Service and Use Charges	67,145,089	71,551,157	74,836,144	4.6%
Interest and Other	570,320	487,196	319,647	(34.4%)
Transfers	8,098,120	52,000	23,000	(55.8%)
Total	\$ 101,247,794	\$ 89,085,793	\$ 91,737,924	3.0%
Dollars by Uses				
Sewer System Maintenance and Admin.	\$ 16,234,314	\$ 19,417,680	\$ 17,759,993	(8.5%)
Sanitary Sewer Rehabilitation	16,000,000	14,475,000	14,475,000	0.0%
Water Pollution Control Plant	50,752,120	44,754,736	46,482,236	3.9%
Ending Fund Balance	18,261,360	10,438,377	13,020,695	24.7%
Total	\$ 101,247,794	\$ 89,085,793	\$ 91,737,924	3.0%

Sewer Service and Use Charge Fund

Budget Category: Sewer System Maintenance and Administration

Budget Category Overview

This category is responsible for Sewer System Maintenance and Administrative Services. System Maintenance is performed by the Department of Transportation, the Department of Public Works, and the General Services Department to repair damaged sewer pipes and maintain

the system infrastructure. Information Technology Department service costs are also included in this category. Administrative Services include support services provided by various City departments, overhead to the General Fund, fees charged by the County for collecting assessments, and audit costs.

Budget Category Summary

Sewer System Maintenance and Administration	2003-2004 Actual 1	2004-2005 Adopted 2	2005-2006 Adopted 3	% Change (2 to 3)
Sewer System Maintenance	\$ 9,756,166	\$ 11,608,144	\$ 11,793,629	1.6%
Administrative Services	6,478,148	7,809,536	5,966,364	(23.6%)
Total	\$ 16,234,314	\$ 19,417,680	\$ 17,759,993	(8.5%)

The following changes were approved in 2005-2006 in the Sewer System Maintenance and Administrative Services allocations:

Adopted Allocation	2004-2005 Adopted	Change	2005-2006 Adopted
Sewer System Maintenance	\$ 11,608,144	\$ 185,485	\$ 11,793,629

Increases to the Sewer System Maintenance Program for the 2005-2006 Adopted Operating Budget reflect salary and benefit cost increases in the Departments of Transportation, Public Works, General Services and Information Technology (\$217,170), and non-personal/equipment adjustments in the Information Technology Department (\$8,140) and Department of Transportation (\$1,250). These increases were partially offset by reductions in lease costs (\$36,075) in the General Services Department and reductions of vehicle maintenance and operating costs (\$5,000) in the Public Works Department.

Sewer Service and Use Charge Fund

Budget Category: Sewer System Maintenance and Administration

Budget Category Summary (Cont'd.)

Adopted Allocation (Cont'd.)	2004-2005 Adopted	Change	2005-2006 Adopted
Administrative Services	\$ 7,809,536	\$ (1,843,172)	\$ 5,966,364
<p>Changes in the Administrative Services Program for the 2005-2006 Adopted Operating Budget are due in large part to in-lieu fee adjustments (\$1.439 million); reduction in overhead charges (\$535,212); reduced workers' compensation claims payments (\$108,000); personal services adjustments in the Environmental Services Department (\$70,017), Planning, Building, and Code Enforcement Department (\$20,056) and City Manager's Office (\$521); and Non-Personal/Equipment changes in the Finance Department (\$1,000). These decreases are partially offset by increases related to City Hall rent costs (\$238,705), salary and benefits increases in the Finance Department and Attorney's Office (\$57,749), changes in fees charged by the County for collecting assessments (\$26,904), and cost allocation plan adjustments to the Environmental Services Department Non-Personal/Equipment allocation (\$7,276).</p>			
Total Sewer System Maintenance and Administration	\$ 19,417,680	(\$ 1,657,687)	\$ 17,759,993

Sewer Service and Use Charge Fund

Budget Category: Sanitary Sewer Rehabilitation

Budget Category Overview

The Sanitary Sewer System Rehabilitation category consists of capital projects designed to rehabilitate the sanitary sewer system, with higher priorities given to those with extensive, severe

deterioration. Rehabilitation projects of existing sewers are selected on the basis of pipe corrosion studies, maintenance reports, infiltration analysis, and actual pipe failures.

Budget Category Summary

	2003-2004 Actual 1	2004-2005 Adopted 2	2005-2006 Adopted 3	% Change (2 to 3)
Sanitary Sewer Rehabilitation				
Transfer to Capital Fund	\$ 16,000,000	\$ 14,475,000	\$ 14,475,000	0.0%
Total	\$ 16,000,000	\$ 14,475,000	\$ 14,475,000	0.0%

No changes are included in 2005-2006 in the Transfer to Capital Fund allocation.

Adopted Allocation	2004-2005 Adopted	Change	2005-2006 Adopted
Transfer to Capital Fund	\$ 14,475,000	\$ 0	\$ 14,475,000

The Sanitary Sewer System Rehabilitation program was for a number of years funded by an annual transfer of \$16 million to the Sewer Service and Use Charge Capital Improvement Fund from the Sewer Service and Use Charge Fund to support the costs of rehabilitation of existing sewers. A decrease of \$1.525 million was approved as part of the 2004-2005 Adopted Operating Budget in response to ongoing deficit spending in the Sewer Service and Use Charge Fund described earlier. For 2005-2006, there is no change to this reduced level of transfer, required until the fund can return to a self-supporting basis. This transfer supports major projects including those related to the rehabilitation of the Major Interceptor System, neighborhood sewers, and the Inflow and Infiltration (I&I) Reduction projects. The rehabilitation projects will prevent and/or correct pipe failures such as collapses, flow stoppage, and the spilling of sewage. The specific elements of this program are described in the 2006-2010 Adopted Capital Improvement Program.

Total Sanitary Sewer Rehabilitation	\$ 14,475,000	\$ 0	\$ 14,475,000
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Sewer Service and Use Charge Fund

Budget Category: Water Pollution Control Plant

Budget Category Overview

This category provides for operational costs, support services, and debt service requirements for the San José/Santa Clara Water Pollution Control Plant (WPCP). This regional wastewater treatment facility serves eight tributary sewage collection agencies, including municipalities and sanitary

sewer districts. The WPCP processes wastewater, operates a Biosolids Reuse Program, and administers the South Bay Water Recycling Project. In addition, it plans, designs, and constructs new wastewater treatment facilities and provides system maintenance.

Budget Category Summary

	2003-2004 Actual 1	2004-2005 Adopted 2	2005-2006 Adopted 3	% Change (2 to 3)
Water Pollution Control Plant				
Treatment Plant Operating Fund	\$ 38,000,000	\$ 32,000,000	\$ 36,500,000	14.1%
Treatment Plant Capital Fund	5,454,000	5,456,000	3,072,000	(43.7%)
SBWR Revenue Bonds ('95)	7,298,120	7,298,736	6,910,236	(5.3%)
Total	\$ 50,752,120	\$ 44,754,736	\$ 46,482,236	3.9%

Transfers to the above wastewater-related funds support the operating, capital, and debt service costs of the Water Pollution Control Plant.

One of the primary sources of expenditures in the past several years has been diversion activities associated with the 120 million gallons per day (mgd) flow trigger to the South San Francisco Bay. The diversion of fresh water effluent from the Bay prevents saltwater marsh conversion. This diversion of fresh water has been primarily achieved through the Revised South Bay Action Plan (Plan), as approved by City Council in June 1997.

The projects within this Plan include expanded water recycling, industrial water recycling/reuse, inflow/infiltration reduction, and environmental enhancement pilots. Recycled water is used by industrial and institutional users, diverting water that would otherwise be discharged to the Bay. For 2005-2006,

approximately 11.2 mgd of recycled water is projected to be diverted, due primarily to the delivery of recycled water. This represents a 0.6 mgd increase compared to the 2004-2005 year-end estimate. This increase is due to the addition of several large customers including the Metcalf Energy Center (MEC). MEC began operations in June 2005 and future years should see an increase in demand for recycled water averaging about seven mgd during the dry weather period.

For the 2004 reporting period the dry-weather flow averaged 97.5 mgd. This effluent flow measure reflects the continuing trend of reduced flows to the Bay. The 2003 reported effluent was 100 mgd representing a significant reduction from 2000 level of 116 mgd. These decreased effluent flows reflect the decline in economic activity as well as increased recycled water usage.

Sewer Service and Use Charge Fund

Budget Category: Water Pollution Control Plant

Budget Category Summary (Cont'd.)

The following changes were approved in 2005-2006 in the support of this fund to the Treatment Plant Operating Fund, Treatment Plant Capital Fund, and SBWR Revenue Bonds ('95) allocations:

Adopted Allocation	2004-2005 Adopted	Change	2005-2006 Adopted
Treatment Plant Operating Fund	\$ 32,000,000	\$ 4,500,000	\$ 36,500,000
For 2005-2006, an increase of \$4.5 million to the transfer from the Sewer Service and Use Charge Fund to the Treatment Plant Operating Fund was approved to provide sufficient funds for program expenses related to the Water Pollution Control Plant. Transfer amounts from this fund to the Treatment Plant Operating Fund vary each year based on the anticipated ending fund balance in that fund.			
Treatment Plant Capital Fund	5,456,000	(2,384,000)	3,072,000
The reprioritization of funds and resources required to fund the construction award of the Plant Reliability Improvements project in 2004-2005 has forced some previously scheduled projects to be rescheduled into future years. The remaining funds represent funding for only the most critical capital needs at the Plant for 2005-2006.			
SBWR Revenue Bonds ('95)	7,298,736	(388,500)	6,910,236
To take advantage of favorable interest rates, the 1995 Bond Series A & B will be refinanced in 2005-2006 generating approximately \$10,000,000 of savings over the life of the bonds.			
Total Water Pollution Control Plant	\$ 44,754,736	\$ 1,727,500	\$ 46,482,236